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NATIONAL FOREIGN ASSESSMENT CENTER

WASHINGTON, D. C. 20505

30 NOV 1981

MEMORANDUM FOR: Mr. Hugh Montgomery
Director of Intelligence and Research
Department of State

SUBJECT: Soviet Economic Leverage Over Poland

Attached please find the memorandum that the National Foreign Assessment Center agreed to draft in lieu of the Special National Intelligence Estimate you requested on 31 October 1981. In an attempt to assure an appropriate focus, conversations were held with Mr. Robert H. Baraz, the Director of your Office of Analysis for the Soviet Union and Eastern Europe. Questions regarding the substance of this memorandum may be directed to [redacted], Chief of the East European Division's Regional Economics Branch. 25X1

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/s/ JOHN N. McMAHON

John N. McMahon
Director

Attachment:
"Soviet Economic Leverage
Over Poland" - EURA-M 81-10019

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SUBJECT: Soviet Economic Leverage Over Poland

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CENTRAL INTELLIGENCE AGENCY
NATIONAL FOREIGN ASSESSMENT CENTER

27 November 1981

MEMORANDUM

Soviet Economic Leverage Over Poland

Summary

The USSR has considerable scope for applying economic pressure against Poland by virtue of its role as a provider of vital raw materials. Moscow so far has avoided economic pressure tactics and instead given considerable aid to the Polish economy since the crisis began in July 1980. It has threatened, however, to reduce the level of assistance in 1982. [redacted] 25X1

Poland is dependent on the USSR for a range of critical industrial materials, including oil (crude and products), natural gas, ores, chemicals, and cotton, and for transportation equipment. For several products, deliveries from the USSR have become indispensable because Poland's lack of hard currency precludes buying Western substitutes. Thus, Moscow is in a position to exert considerable pressure if it believes it stands to gain in terms of its political objectives. [redacted] 25X1

In any event, the Soviets may be less generous in aid to Poland next year because of their own economic and hard

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At the request of the Department of State, this memorandum was prepared by [redacted] 25X1
[redacted] *East European Division, Office of European Analysis, with* 25X1
contributions from [redacted] *East European* 25X1
Division, Office of European Analysis, and [redacted] 25X1
[redacted] *Office of Soviet Analysis. It was coordinated* 25X1
with the NIO for USSR/Eastern Europe. Research was completed on 25 November 1981. Comments and questions are welcome and should be addressed to Chief, East European Regional Economics Branch, East European Division, EURA, [redacted] 25X1

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currency problems. If Moscow decided to apply additional economic pressure, it probably would act selectively to intimidate the Poles into curbing unacceptable political activity, to prod them into acting more resolutely to improve economic performance, or to discredit Solidarity by keeping the economy off balance. A Soviet application of economic leverage on a major scale would signify that Moscow was prepared to intervene militarily. 25X1

Polish retaliation by cutting off exports to the USSR and Eastern Europe would be unlikely to have sufficient impact to influence Soviet strategy. Poland would be loath to use its only trump card--disruption of the transport link between the USSR and GDR--for fear of precipitating a Soviet invasion. 25X1

Moscow's Economic Strategy to Date

Moscow's principal economic actions since the onset of the Polish crisis in July 1980 have been in the direction of more generous assistance to Poland. Although Soviet aid has been significant in propping up the Polish economy by providing needed goods and easing hard currency problems, it has not been sufficient to arrest the downturn in economic activity or to keep Poland from the brink of default. 25X1

In deciding to provide moderate amounts of aid, Moscow must have concluded that its interests would be better served by helping to keep the Polish economy afloat than by using economic leverage to prod Poland's political leaders. The Soviets presumably reasoned that a more seriously damaged Polish economy would increase the chances for political and social chaos that would require Soviet military intervention, not necessarily at a time of their own choosing. They may also have sought to ration assistance with the view that a continuing moderate economic decline would erode popular support for Solidarity and for reformers in the Polish United Workers (Communist) Party. 25X1

The Soviets provided up to $1 billion in hard currency help early in 1981, but none after the first quarter. This help included a financial grant, credits for food purchases in the West, and rescheduling of some of Poland's hard currency debt to Moscow. The Soviet Union agreed in addition to postpone the repayment of soft currency debt for five years. More importantly, the Soviets have allowed Poland to run a 1.4 billion ruble ($2 billion) trade deficit

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in 1981, reflecting both increased Soviet deliveries and reduced Polish exports. Speeded up deliveries of some Soviet goods have substituted for Western goods, allowing the Poles to economize on hard currency. For example, Poland has relied almost exclusively on the USSR for oil imports in 1981, thus avoiding the expenditure of hard currency on high priced OPEC oil as in past years. The USSR could have sold many of the goods supplied to Poland on the world market for hard currency. Taken alone, the roughly 13 million tons of crude oil and 3 million tons of oil products provided to Poland this year could have earned the USSR about $4 billion in hard currency if sold in the West. [redacted] 25X1
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Although there is no confirmation, planning chief Baybakov reportedly warned Polish officials in September that Moscow intends to reduce aid next year. The Soviets are apparently taking a tough stance in negotiating a 1982 trade pact, and it now seems that the allowable trade deficit will be sharply reduced. Other CEMA countries, in particular Czechoslovakia and East Germany, are not likely to aid Poland by allowing large trade deficits in 1982. Although non-USSR CEMA provided a moderate amount of aid at the beginning of the Polish crisis, most CEMA countries are now demanding balanced trade. [redacted] 25X1

The status of CEMA and Soviet hard currency aid for 1982 is still unclear. Moscow recently rejected a proposal by US bankers that CEMA's International Investment Bank borrow $300-500 million to help Poland pay some $500 million in interest due on signature of the private debt rescheduling agreement in December. The Soviets could provide hard currency help for Poland in 1982 through less publicized arrangements as in the past, but their own deteriorating hard currency position will strengthen their reluctance to do so. [redacted] 25X1

Polish Vulnerabilities to Soviet Economic Sanctions

Soviet aid, combined with reduced Polish capacity to buy in the West, has led to a greater Soviet share in Polish imports this year. Moscow could exert considerable leverage by demanding balanced trade and denying further hard currency loans and grants to Poland. If the Soviets were to demand balanced trade, Poland would need to reduce its current rate of imports from the USSR by one-third to match its current rate of exports. Alternatively, if Poland were forced to increase exports of raw materials--such as coal--

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to the USSR, this would deprive Poland of critical hard currency exports. Polish authorities would meet resistance from Polish consumers and Solidarity if they were to divert scarce manufactured and consumer goods from the domestic market to the Soviets. 25X1

Soviet Share of Total Polish Imports - Percent

	1980	First Half 1981
Total Imports	33.2	39.8
Fuels and Energy	67.7	84.7
Industrial Products:		
Metallic Ores	38.4	50.0
Machinery & Spare Parts	35.3	39.6
Chemicals	13.7	24.3
Paper and Wood Products	39.6	57.3
Consumer Manufactures	23.8	32.3
Processed Foods	3.7	2.5
Agricultural Products	3.4	2.9

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For several products--oil (crude and products), natural gas, ores, chemicals, cotton, and transportation equipment--deliveries from the USSR have become indispensable since a lack of hard currency has precluded purchases of Western substitutes. Given the extent of Polish dependence on the USSR for energy and many raw materials, Moscow could bring about the collapse of the Polish economy by cutting off supplies of these vital goods. Moscow might disrupt supplies of these goods in a progressive and selective way to pursue more limited objectives. It could apply only minimal pressure, however, in the area of consumer goods.

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Energy

The Soviets possess an awesome lever in oil alone. During the 1970s, over 80 percent of Poland's crude oil came from the Soviet Union; in 1981 Moscow provided almost 100 percent. The Soviets could embargo deliveries of petroleum and petroleum products selectively or progressively. Should the Soviets decide to withhold all oil, the Poles would be unable to overcome the ensuing bottlenecks because petroleum accounts for over four-fifths of the energy used in the transportation sector. Coal would pile up at the mines, agricultural products would remain on the farms, and

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imported grain would stand in the ports. Even though most electric power is generated by coal, industrial activity would wind down for lack of transportation. The impact on the economy would be quick, far reaching, and paralyzing. [redacted] 25X1

Industries

Several Polish industrial branches are particularly vulnerable to an interruption of Soviet deliveries. The ferrous metals branch imports three-quarters of its iron ore from the USSR. A shutdown of this branch would severely hurt the transportation equipment, construction, and machine building sectors. The textile industry also depends on the USSR for a large share of its raw materials--particularly raw cotton. Moreover, more than one-third of Polish imports of machinery and equipment is supplied by the USSR. Although Soviet capital goods and spare parts are generally inferior to what is available in the West, they are compatible with Polish equipment and not easily acquired elsewhere. [redacted] 25X1

Consumer Goods

The USSR has little economic leverage over Poland in the food and agricultural sector. Only about 3 percent of agricultural product imports and 2.5 percent of processed food imports came from the USSR in the first half of 1981; most of these imports come from the West. Moscow could exert some economic leverage in the agricultural area, however, by cutting natural gas shipments (which are vital for fertilizer production) and deliveries of agricultural implements such as tractors. [redacted] 25X1

The Soviet share in Poland's imports of manufactured consumer goods is higher--about 32 percent of total imports in the first half of this year. The Poles would not be able to replace Soviet deliveries of these goods by increasing domestic production. The Polish consumer is used to shortages of durable goods, however, and presumably would view additional shortfalls as Soviet-induced. [redacted] 25X1

Economic Costs of Leverage

The economic cost to the USSR of applying economic leverage would range from small to moderate depending on the Polish response. Even if the Poles countered with an embargo, the costs to the Soviet economy would not be

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prohibitive. Although Poland accounts for 8 percent of the USSR's total imports--11 percent of its imports of machinery and equipment--the USSR is not critically dependent on Poland for any single commodity. Loss of Polish sulfur, which provided about 10 percent of total Soviet consumption in 1980, would cause some short term disruption. Although Polish coal accounts only for a small share of total Soviet coal consumption, a complete cutoff would have some repercussions because it could not easily be replaced in the steel mills of the western USSR. Finally, loss of Polish exports of machinery, equipment, and transportation equipment would result in initial dislocations but would not be disabling. 25X1

The repercussions of a Soviet cutoff of all exports to Poland would, of course, almost certainly go beyond a cessation of Polish exports to the USSR. Under most foreseeable circumstances, Poland probably would stop exports to other East European countries as well, leading to East European demands for Soviet assistance. East Germany, whose steel and chemical industries have been heavily dependent on Polish hard coal, already has been forced to turn to West German suppliers to make up for a falloff in Polish deliveries. 25X1

Perhaps the greatest deterrent to Soviet economic pressure is Poland's key position in Eastern Europe's transportation network. A move by Warsaw to block transportation through its territory would place significant, immediate pressure on East Germany and pose a logistical threat to the Group of Soviet Forces, Germany. The already overburdened rail network in Czechoslovakia, poor regional road systems, and a general shortage of trucks mean that alternate overland routes from the USSR are inadequate to transport the supplies normally shipped through Poland. The Poles presumably would be reluctant to use this weapon, even in the face of a total Soviet embargo, for fear of precipitating Soviet military intervention. 25X1

Future Soviet Strategy on Economic Leverage

Moscow can choose among three options in deciding whether and how to apply its powerful economic weapon:

-- Continue the past economic relationship;

-- Cut back aid moderately; or

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-- Impose severe economic sanctions.

If Moscow provides an amount of assistance in 1982 comparable to that in 1981, it would do so at considerable cost given its own worsening hard currency position. This strategy would provide sufficient support to prevent collapse and disorder and permit the Soviets to keep their longer term options open. 25X1

A moderate cutback in Soviet economic aid to Poland would represent an intensification of Moscow's pressure and would be intended to accomplish several ends:

-- Intimating to the Polish leaders and population that worse reprisals may follow if unacceptable political activities are not curbed;

-- Creating a greater state of uncertainty in the Polish regime as to how much Soviet assistance it can expect over the longer term, thereby prompting it to act more urgently to improve economic performance;

-- Reinforcing the regime's argument that some unpopular measures must be imposed to deal with Poland's serious economic problems;

-- Discrediting Solidarity by blaming the attendant increase in economic difficulties on the union's disruptive activity;

-- Countering the widespread belief among Soviet citizens that the Poles are getting a free ride at their expense. 25X1

A Soviet decision to impose more drastic economic sanctions (e.g. denial of essential raw materials) would indicate Moscow's belief that prospects in Poland had taken a turn for the worse and that it should precipitate a showdown. The Soviets would take such action only if they were prepared to intervene militarily in the highly likely event that the Polish authorities were unable to maintain order. 25X1

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Imposition of severe sanctions could be prompted by any of several future developments, including:

-- A perception that events in Poland were having repercussions within the USSR or elsewhere in Eastern Europe on a scale that suggested they could not be arrested except by forcefully suppressing the reform movement in Poland;

-- A conclusion that long-term trends in Poland were going against vital Soviet interests and could not be reversed or altered except through drastic action;

-- Loss of remaining confidence in Poland's leaders and doubt that more acceptable leaders could be installed by conventional means. 25X1

Table 1: Dependence on the USSR for Selected Commodities, 1979

	Total Imports	Imports from USSR	Total Domestic Production	Imports from USSR as a Percent of Domestic Consumption
Crude Oil (thousand tons)	16,608	12,953	331	76.5
Natural Gas (mln. m^3)	3,983	3,983	7,335	35.3
Electric Power (mln. kwh)	913	491	117,468	0.4
Iron Ore (thousand tons)	18,872	13,447	249	70.3
Rolled Steel (thousand tons)	1,041	637	13,577	4.4
Manganese Ore (thousand tons)	740	521	---	70.4
Chrome Ore (thousand tons)	211	143	---	67.8
Locomotives (units)	212	172	291	34.2
Passenger Cars (thousand units)	22	12	320	3.5
Trucks (thousand units)	15	9	51	13.6
Nitrogen Fertilizer (thousand tons)	207	157	1,376	9.9

	Total Imports	Imports from USSR	Total Domestic Production	Imports From USSR as a Percent of Domestic Consumption
Synthetic Rubber (thousand tons)	55	30	130	16.2
Asbestos (thousand tons)	103	45	52	29.0
Sawn Soft Wood (thousand m^3)	179	179	7,241	2.4
Cellulose (thousand tons)	249	97	494	13.1
Cotton (thousand tons)	163	112	---	68.7

NOTE: Data for 1979 are the latest complete trade statistics. Poland's dependence on the USSR is now higher for many products because of the downturn in domestic production and because of cutbacks in imports from the West. For example, Poland's dependence on Soviet oil in 1981 is nearly total because of the inability to finance imports of OPEC oil. Dependence on Soviet gas this year has increased to 45 percent because of Orenberg pipeline deliveries. 25X1

MEMORANDUM FOR: Director of Central Intelligence

As you requested this morning, we are forwarding the two papers on Poland for your weekend reading. The Polish aid paper was handcarried to Allen Lenz on Friday afternoon.

[redacted] 25X1

Director
European Analysis

Date 4 Dec '81

FORM 5-75 101 USE PREVIOUS EDITIONS

GPO : 1981 O - 345-783

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REMARKS:

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Dec.

Per your request.

Bill - you may want to send this to Commerce, Treasury, Def, etc. I have asked [redacted] to give copy to Bush 25X1

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